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IN THE

Supreme Court of the United States

October Term, 1966

No._____

BOB HINDES and wife, DOROTHY LEE HINDES,
PETITIONERS,

versus

UNITED STATES OF AMERICA,
RESPONDENT.

Petition for a Writ of Certiorari

to the United States Circuit Court of Appeals,
for the Fifth Circuit.

May it please the court:

Bob and Dorothy Lee Hindes, husband and wife, pray that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit entered in the above entitled cause on January 13, 1967.

OPINIONS BELOW

The first opinion of the District Court in this litigation is officially reported at 214 F. Supp. 583, and the first opinion of the Circuit Court of Appeals is reported at 326 F. 2d 150. The opinion of the District Court on remand is reported at 246 F. Supp. 147, and the second opinion of the Circuit Court of Appeals is set forth in the Appendix, **Infra**, p. 5-11.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 13, 1967 (Appendix Infra). The jurisdiction of this Court is invoked under Supreme Court Rule 38.

QUESTION PRESENTED

May a direct tax prohibited by Section 2, Clause 3, and Section 9, Clause 4, of Article I of the United States Constitution be levied upon a citizen in the guise of an income tax where the alleged income was not received by the citizen, either actually or constructively.

LAW INVOLVED

The Sections and Clauses of the Constitution involved are set forth in the Appendix, **Infra** p. 12.

SUMMARY STATEMENT OF THE FACTS

During 1957 petitioners entered into a written **earnest money contract** whereby petitioners agreed to sell a ranch that they owned to one Sechrist for $300,000.00 cash. (R. 6). Later, petitioners learned that an installment sale would result in a considerably lower tax to them (R. 6). Sechrist

would not buy on the installment plan because he had received the $300,00.00 from an involuntary conversion and had to reinvest the entire amount to avoid paying income taxes on the gain realized from the conversion.

Petitioners' attorney suggested that he would form a corporation to buy the ranch for $265,000.00 on the installment plan, and that the corporation would sell the ranch for $300,000.00 cash. Petitioners agreed to the plan and a corporation in which petitioners owned none of the capital stock was formed (R. 7).

Petitioners deeded the ranch to the corporation, having first secured Sechrist's permission so to do (214 F. Supp. 583). The corporation then deeded the ranch to Sechrist (R. 7).

In their income tax return for 1957, petitioners reported the sale on the installment plan. The District Court held that the sale was a closed transaction and that petitioners had realized $300,000.00 from the sale. (214 F. Supp. 583). On appeal, the Circuit Court of Appeals held that the sale was a closed transaction but reversed and "remanded for consideration on the merits of the question of whether the additional $35,000.00 was properly assessed to taxpayers as having been a part of the substance of the transaction". (326 F. 2d 150)

On retrial the case was submitted on a stipulation of facts (R. 3-5).

The District Court again held that petitioners had realized $300,000.00 from the sale of their ranch but allowed "the real estate commission, documentary stamp fee, abstract fee" (all paid by the corporation), "and legal fee disbursed to the attorney by the corporation upon liquidation" to be deducted as selling expenses. (R. 15).

This part of the District Court decision was affirmed by the Circuit Court of Appeals (Appendix Infra).

The net effect of the two decisions is to tax petitioners on $13,226.36 that was received by the stockholders of the corporation.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred in holding that petitioners were subject to income tax on income that they did not receive, either actually or constructively.

REASONS FOR GRANTING THE WRIT

The writ should be granted in order to reverse a decision that is in direct conflict with the express provisions, as well as the spirit, of the Constitution of the United States.

CONCLUSION

Wherefore it is respectfully submitted that this petition should be granted.

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San Antonio, Texas
Attorney for Petitioner

Of Counsel:
M. McDonnold

CERTIFICATE OF SERVICE

I hereby certify that the respondent has been served by mailing four copies of this brief by United States mail, postage prepaid, to the Solicitor General of the United States, Washington, D.C.

APPENDIX

Opinion and Judgment of the United States Court of Appeals for the Fifth Circuit: Before TUTTLE, Chief Judge, AINSWORTH and DYER, Circuit Judges.

TUTTLE, Chief Judge: This tax case is before us for the second time. In a prior decision, Hindes v. United States, 5 Cir., 326 F. 2d 150, we affirmed the judgment of the trial court in denying a claim for refund of taxes paid by Bob Hindes and his wife, Dorothy Lee Hindes, for the year 1957.

It will do little good to restate all of the facts in the case, since they have been fully dealt with in our prior decision and in the subsequent opinion of the trial court on remand, 246 F. Supp. 147. Briefly stated, the issue here for decision arises from the following facts:

During the year 1957, Hindes negotiated with one Sechrist, for the sale of the Hindes ranch for the sum of $300,000. A written contract was entered into and Hindes accepted a $5,000 earnest money deposit. Thereafter, he reported this fact to his lawyer, who suggested that it would be cheaper taxwise if the sale were made on an installment basis. Title 26, U.S.C.A. No. 453.

Thereafter, the lawyer organized the corporation, Tower Farm and Cattle Co., Inc., the stockholders consisting of Hindes's mother and father and the lawyer. The mother and father contributed $1,000 and the lawyer contributed $1,000 as the capital stock of the corporation. Thereupon, Hindes sold the farm to the corporation for $265,000 on ten year installments. The corporation then sold the ranch to the original purchaser, Sechrist, for $300,000 cash. Out of the $300,000, the corporation paid off a $58,574.81 first mortgage, leaving a net of $241,425.19, and a net due to Hindes of

$206,425.19. The corporation paid the real estate commission of approximately $15,000, and the first installment of $20,000 to the taxpayers. Within a few days thereafter, the corporation made an unsecured four percent loan to Hindes in the amount of $200,000, due five years from date, with interest payable annually. The four percent interest equalled the interest that was due to Hindes on the installment sales. At the proper time the corporation paid $5,617.18 income taxes on the short term capital gain representing the profit of $35,000 difference between the $265,000 it bought the property from Hindes for, and the $300,000 it sold it for to Sechrist, after deducting the expenses of sale.

Taxpayers reported the sale price of $265,000 on their income tax return for 1957 on the installment basis. Of course, when the return was examined and the facts were ascertained, the installment basis for the contract was disallowed, and a deficiency was asserted against the taxpayers on the basis of the sale at $300,000 less expenses. The taxpayers paid the deficiency and filed timely claim for refund and thereafter filed this suit.

The trial court granted the government's motion for summary judgment, which, in effect, provided for a computation of the tax substantially along the lines asserted by the Commissioner.

Upon appeal, this court affirmed the judgment of the trial court to the extent of approving the determination that there was a non-installment sale of the ranch by Hindes to Sechrist under the principle of *Commissioner v. Court Holding Company*, 1945, 324 U.S. 331. The Court remanded for initial consideration by the trial court the question whether the sale by Hindes to Sechrist should be treated as a sale for the full $300,000 or for only the $265,000 that was

the amount actually agreed to be paid by Tower Farm and Cattle Company, the corporation set up by the **taxpayers** as a conduit for the transfer of the property to Sechrist.

Upon remand, the trial court determined that the real purchase price for which the ranch was sold by Hindes to Sechrist was the full $300,000, less commissions, attorneys fees and other necessary expenses. However, the trial court determined that since the corporation had paid a federal income tax of $5,617.18 on a corporate return for the year 1957, Hindes should be given credit for this payment. That court was confronted on remand with the question of what adjustment, if any should be made in the taxpayers' income tax liability by reason of the fact that, on the theory under which the court had disallowed the installment sale, the corporation did not owe the tax which it paid, but the government had collected this much of the tax that was generated by reason of the sale. The trial court concluded that since the corporation was a sham, and since it realized no income from the transactions in its role as a conduit for the sale, and since the taxpayers, although not the shareholders, were the ultimate losers if the $5,617.18 in taxes paid by the corporation was not to be credited to their account, it should allow a credit in that amount against taxpayers' liability, conditioned upon a filing of a claim for refund by the corporation within ten days after the judgment in the case becomes final.

The taxpayers appealed from the trial court's decision as to the disposition of the $35,000 difference, and the government appealed from the part of the trial court's order which allowed a credit for the corporation's tax payment.

Nothing need be said about the taxpayers' appeal. The brief, filed in their behalf, is completely without substance.

On the direct appeal, therefore, the judgment of the trial court is affirmed.

The government's appeal from the allowance of the credit of the tax paid by the conduit corporation, presents an issue as to which the equities appear on the surface to be in favor of the taxpayer. This is recognized by the government, because unless the decision of the trial court is affirmed in relation to this payment, the United States will have been permitted to recover part of the taxes twice. This follows because, under the court's decision, Hindes will pay a tax on the gain from the sale of the ranch without the benefit of the installment provisions as a sale for $300,000, whereas the corporation which set up by Hindes upon the advice of his lawyer in the futile effort to change the nature of the transaction, has already paid $5,617.18 taxes on the sale by it to Sechrist, on the theory that it had enjoyed a gain between the price at which it acquired the property from Hindes and the price at which it was sold for $300,000 to the ultimate purchaser.

The government points out, however, that both credit for taxes paid and the refund of taxes illegally collected can be obtained by taxpayers only by following the statutory provisions relating to claims for credit or refund. (Internal Revenue Code of 1954, Section 65 — 11 (a)(b)(1).) The corporation filed no claim for refund for the taxes erroneously paid by it, and the time has long since expired during which it could make such claim. The taxpayer, Hindes, in the claim for refund made by him, did not claim credit for the amount paid by the corporation. Of course, we recognize that it would be inconsistent with the legal position which the corporation and Hindes then took for either of them to pursue a claim for refund or credit except

by way of the filing of a protective claim by the corporation, or a protective claim for credit by Hindes.

It is to be noted that this court, on the prior appearance of the case here, did not expressly deal with Tower Farm and Cattle Company, Inc., as a nullity or a sham. We held that the sale by Hindes, under the principles of Commissioner v. Court Holding Company, supra, since the contract of sale had been executed before the property was thereafter transferred to the corporation for subsequent transfer to the purchaser.

The cross-appellee, through his counsel has not seen fit to call our attention to any basis on which such a corporation as that created as a conduit for an unsuccessful transaction, would be entitled to have a tax refund made to it, without complying with the statutory requirement respecting a claim for refund. Nor has counsel seen fit to discuss, for our enlightenment, any principle of law or equity which would warrant the court in setting aside or mitigating the effect of the claim for refund requirements.

The government points to the proposition that, even though the taxpayers would have a right to take advantage of the payment made by the corporation, they may not obtain credit or equitable recoupment, unless the claim for refund which they filed with the Commissioner asserted these grounds as a basis for the refund, citing *Carmack* v. *Scofield*, 5 Cir., 201 F. 2d 360; *Philadelphia Trust Co.* v. *United States*, 3 Cir., 222 F. 2d 379; *Campagna* v. *United States*, 2 Cir., 290 F. 2d 682, 685; *Ladd* v. *Ridell*, 9 Cir., 309 F. 2d 51, 54. In the Carmack case this Court said:

> "The filing of a timely claim for refund is a statutory prerequisite to a suit to recover taxes alleged to have been illegally collected. 26 U.S.C.A. No. 3772 (a)

(1); *U.S.* v. *Felt & Tarrant Mfg. Co.*; 283 U.S. 269, 51 S. Ct. 376, 75 L.Ed. 1025. The principal requirement of the statute, supra, and regulations supplementary thereto, is that the Commissioner be apprised by the timely filing of a claim of the exact basis upon which the claim for refund is predicated. *U.S.* v. *Pierotti*, 9 Cir., 154 F. 2d 758. A taxpayer is not permitted to advance one ground for refund in his claim filed with the Commissioner and thereafter rely upon an entirely different ground in a subsequent suit for refund, but is confined to the scope of the grounds for refund asserted in his claim filed with the Commissioner. *J.P. Stevens Engraving Co.* v. *U.S.*, 5 Cir., 53 F. 2d 1; *Snead* v. *Elmore*, 5 Cir., 59 F. 2d 312; *B.F. Goodrich* v. *U.S.*, 9 Cir., 135 F. 2d 456, affirmed on other grounds 321 U.S. 126, 64 S. Ct. 471, 88 L.Ed. 602; *Ney* v. *U.S.*, 8 Cir., 171 F. 2d 449. Exceptions to this rule are not material here. See *Tucker* v. *Alexander*, 275 U.S. 228, 48 S. Ct. 45, 72 L.Ed. 253. The wisdom of the rule was explained by this Court in *Snead* v. *Elmore*, supra, where we pointed out that its purpose is to permit the Commissioner to correct claimed errors in the first instance and, if disagreement persists, to limit the litigation to the issues which have been reexamined by the Commissioner and which he is prepared to defend." 201 F. 2d 360, 361, 362.

Although taxpayers' counsel has not sought to assert any basis on which the court could overlook the requirements of filing a claim for refund by the corporate taxpayer, or a claim for credit by the individual taxpayers here, we have surveyed the provisions of Sections 1311, 1312 and 1313 of the Internal Revenue Code of 1954, in order to determine whether these sections contained some provisions warranting mitigation of the effect of the statute of limitations which now bars any refund or credit for the payment of $5,617.18 by the corporation. We conclude that,

since the corporation was not a "related taxpayer" to Hindes within the Definition Section of this Chapter of the Code, there is no relief available here.

The judgment is AFFIRMED on the appeal of the taxpayers, and is REVERSED on the appeal of the United States, and the case is REMANDED to the district court for further proceedings not inconsistent with this opinion.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed on the appeal of the taxpayers, and is reversed on the appeal of the United States, and in this cause be, and the same is hereby remanded to the said District Court for further proceedings not inconsistent with the opinion of this Court.

January 13, 1967

Issued as Mandate:

UNITED STATES CONSTITUTION — ARTICLE 1

Section 2, Clause 3. Apportionment of representatives and taxes.

Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons. The actual Enumeration shall be made within three Years after the first Meeting of the Congress of the United States, and within every subsequent Term of ten Years, in such Manner as they shall by Law direct. The Number of Representatives shall not exceed one for every thirty Thousand, but each State shall have at Least one Representative; and until such enumeration shall have at Least one Representative; and until such enumeration shall be made, the State of New Hampshire shall be entitled to chuse three, Massachusetts eight, Rhode-Island and Providence Plantations one, Connecticut five, New York six, New Jersey four, Pennsylvania eight, Delaware one, Maryland six, Virginia ten, North Carolina five, South Carolina five, and Georgia three.

Section 9, Clause 4. Capitation and other direct taxes

No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 1082

BOB HINDES, ET AL, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

In 1957, petitioners (husband and wife) entered into a written contract in which they agreed to sell a ranch to Sechrist for $300,000 in cash and Sechrist gave petitioners an earnest money deposit of $5,000. Thereafter, petitioners' attorney informed them that their taxes would be considerably lower if they made the sale on the installment method, receiving less than 30 percent of the purchase price the first year and taking notes for the remainder of the $300,000. Se-

christ, however, insisted on paying the entire purchase price in cash, because he had received $300,000 from an involuntary conversion and had to reinvest the entire amount in order to avoid paying an income tax on the gain realized on the conversion. Pursuant to the advice of petitioners' attorney, the following plan was therefore carried out:

The Tower Farm and Cattle Company, Inc., was chartered under Texas law, with petitioners' parents and attorney as the stockholders. Petitioners sold the ranch to the corporation for an agreed price of $265,000 to be paid in installments over a 10-year period. The corporation then conveyed the ranch to Sechrist for $300,000 cash, using the cash to pay (1) a mortgage on the property, (2) real estate commissions and related selling expenses, (3) a $5,678 income tax on its gain on the sale (*i.e.*, the difference between its "cost" basis of $265,000 and its proceeds of sale of $300,000 less selling expenses), (4) $20,000 to petitioners as the first installment of the corporation's $265,000 debt to them, (5) $200,000 to petitioners as an unsecured five-year loan at four per cent interest, and (6) the remainder of approximately $15,000 as a distribution to the stockholders (who had initially invested $2,000). (Pet. 3, 5-6; R. 6-7).[1]

The district court concluded that the corporation had been used as a conduit in the sale of the ranch from petitioners to Sechrist in an effort to convert a cash sale into an installment sale. 214 F. Supp. 583.

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[1] "R." references are to the record in the court below.

On appeal, the Fifth Circuit agreed, at least to the extent of the $265,000 realized by petitioners in their sale to the corporation. 326 F. 2d 150, certiorari denied, 377 U.S. 908. The court of appeals remanded for consideration of whether the additional $35,000 ($300,000 less $265,000) received by the corporation on the sale to Sechrist was taxable to petitioners. *Ibid.*

On remand the district court concluded that petitioners had sold the property to Sechrist for $300,000, using the corporation as a conduit, and that the $35,000 (less the expenses of sale which petitioners would have incurred had they made the sale directly) was received, in substance, by the petitioners as an integral part of the sale transaction (R. 9). The district court allowed petitioners a credit against their own tax liability for the $5,678 paid by the corporation as federal income tax on the sale of the land, on the condition that the corporation (which was not a party to the litigation) file a refund claim within ten days after the judgment herein becomes final (R. 13-14, 18-19). The corporation had never filed a claim for refund of these taxes and the statute of limitations had already run; moreover, petitioners' refund claim in no way sought to recover the income tax paid by the corporation nor did they allege that a part of the amount which they were seeking to recover had previously been paid by the corporation (Ex. 8, I-R. 62-68).[2]

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[2] "I-R." citations are to the pages of the printed record on appeal in the previous appeal of this case (C.A. 5, No.

The Fifth Circuit affirmed on the petitioners' appeal, thus upholding the district court's conclusion that the petitioners had sold the property to Sechrist. The court reversed on the government's appeal, holding that since no claim for refund had been filed with respect to the tax paid by the corporation, petitioners could not claim credit for it.

In their petition for a writ of certiorari, petitioners argue that they have been taxed on an amount which was actually received by the shareholders of the corporation, and that this exaction (in the guise of an income tax) constitutes an unapportioned direct tax prohibited by Article 1, Section 9, Clause 4, of the Constitution of the United States (Pet. 2, 4). This contention is without merit. Even an erroneous application of the income tax laws does not automatically withdraw an income tax from the sanction of the Sixteenth Amendment. Moreover, the income tax laws were correctly applied in the instant case. Petitioners entered into a written contract to sell the property to Sechrist for $300,000 and accepted a $5,000 deposit. They could not escape the income tax liability thereby created merely by conveying the property to Sechrist through a conduit, a newly-organized corporation owned by their parents and attorney. As this Court concluded with regard to a similar scheme in *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334:

20,604), and "II-R." citations are to the pages of the supplemental printed record in the earlier case. We are lodging herewith a Xerox copy of both these documents.

> A sale by one person [here petitioner] cannot be transformed for tax purposes into a sale by another [here the corporation] by using the latter as a conduit through which to pass title. To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.

See also *Harrison* v. *Schaffner*, 312 U.S. 579; *Griffiths* v. *Commissioner*, 308 U.S. 355.

Petitioners complain that they are being taxed on approximately $15,000 which went to the stockholders of the corporation. However, petitioners had it in their power to receive the full $300,000 sales price and voluntarily chose to convey their rights to the corporation (owned by their parents and attorney) for less than $300,000. It is well established that:

> with reference to taxation, if a man disposes of a fund in such a way that another is allowed to enjoy the income which it is in the power of the first to appropriate it does not matter whether the permission is given by assent or by failure to express dissent. The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not.

Corliss v. *Bowers*, 281 U.S. 376, 378; see also, *Lucas* v. *Earl*, 281 U.S. 111; *Helvering* v. *Horst*, 311 U.S. 112. Since petitioners sold the ranch to Sechrist for $300,000 and then voluntarily agreed to

divert part of the sales proceeds to the corporation, the lower courts correctly held them taxable on the full proceeds of sale.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

THURGOOD MARSHALL,
Solicitor General.

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GILBERT E. ANDREWS,
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MARCH, 1967.

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